Blue Harbour’s Formula For Successful Activism

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Activist investing is now a mainstream tactic, but while some funds are learning new tactics that have only recently become widely accepted, others have years of experience under their belt. In a recent interview with Value Investor Insight, Blue Harbour Group founder Clifton Robbins explains the approach that has earned Blue Harbour an annualized 8.9% return since its inception in 2004.

Think like an owner: Blue Harbour’s Robbins

“The company has to be a great investment, fundamentally undervalued and trading at a discount to what we consider to be its intrinsic value. But in addition we have to have ideas we want management to pursue over time to unlock the value,” says Robbins. “The key is to think like an owner, literally asking of any potential investment, ‘If we owned the whole company, what would we do differently?’”

But Robbins isn’t interested in proxy fights and harsh tactics, and he doesn’t want to fix broken companies (though he says there is certainly money to be made doing so). Blue Harbour looks for companies with market caps of no more than $10 billion, and usually less than $5 billion, that have a good business and strong management, but who might not be aware of all the options available to them.

“These are great operators with plenty of intellectual firepower, but when we start talking about things like maximizing return on invested capital, using a Morris Trust or securitizing real estate assets, it’s clear that is not typically how they spend their day,” says Robbins.

When his team finds a possible match, the first step is for Blue Harbour to set up a ‘farm-team’ position, worth 1% – 3% of their portfolio. This allows them to continue with due diligence and to start talking to management about their ideas for unlocking shareholder value. Over the next quarter or two, the position will either be increased to 6% – 12% of the portfolio or sold, depending on how receptive management is to their ideas (and assuming no other problems come to light). Since Robbins wants to be in and out in two – three years (and aims for a 30% to 50% return on each play) and only takes a core position when he can work productively with management, he doesn’t seek board positions for the companies he invests in.

Maintaining ties after the investment ends

That doesn’t mean that Robbins cuts ties with management teams after he exits a position. He gives the example of IT firm CACI International, which Blue Harbour first invested in three or four years ago to convince management that it should be using extra cash to buy back its undervalued stocks instead of retiring a 2% term loan, selling after the stock price rose significantly. Two years ago CACI International Inc (NYSE:CACI)'s stock price fell because of the government sequestration, even though its cybersecurity and anti-terrorism services probably weren't going to suffer.

"That wasn't enough to get back in, though, we also had to have new ideas to help unlock value," says Robbins, sticking to his dual criteria of buying undervalued companies where he can bring new ideas. He recommended a synergistic acquisition (an $820 million acquisition was announced last year) and dividend payments, which he says he is still working for.

Specifically, Clifton Robbins noted in regards to CACI the following:

We maintained our relationship with management, which we very much respect, and we got another chance to buy two years ago when the stock fell sharply on concerns about the government shutdown and sequestration. We thought the market was punishing all contractors indiscriminately, but our conviction was that any cutbacks weren't going to be in the cyber-security and anti-terrorism areas so important to CACI. That wasn't enough to get back in, though, we also had to have new ideas to help unlock value.

We thought management should consider making a large synergistic acquisition and also consider instituting a dividend. We ended up buying 10% of the company, and six months ago it announced the $820 million acquisition of Six3 Systems, which strengthens its position in several areas and we believe will prove to be a highly accretive use of cash. The dialogue about the dividend is ongoing.

Experience matters a ton: Blue Harbour's Robbins

Robbins says that activism is here to stay – one of the lessons of the financial crisis is that investors need to assert their rights to make sure the CEO is protecting their interests – but he isn't worried about the increase in competition.

"Activism is very hard to do well. You need to have credibility with management teams. You need to have experience working on and with boards. You need to have a large support network," says Robbins. "Experience matters a ton."